REPORT OF THE AUDITOR-GENERAL TO NORTHERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON \\KHARA HAIS LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the \\Khara Hais Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

6. The financial statements of the municipality are materially misstated as the municipality did not depreciate property, plant and equipment, as required by Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment*. The effects on the financial statements are that property, plant and equipment, net surplus and accumulated surplus are overstated by R4 212 749 (2011: R34 125 674) respectively.

7. In addition I was unable to obtain sufficient appropriate audit evidence to confirm the recording of property plant and equipment, stated at R2 048 725 893 in the financial statements. I was unable to confirm that all assets are appropriately recorded and disclosed in note 1 to the financial statements by alternative means. Consequently, I was unable to determine whether any further adjustments relating to property plant and equipment in the financial statements was necessary.

Revenue from exchange transactions

8. The municipality did not have adequate systems in place to maintain records of revenue from exchange transactions stated at R255 084 105 in the financial statements. I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of revenue stated at R255 084 105 in the financial statements. I was unable to confirm by alternative means whether all revenue transactions were recorded and appropriately disclosed in notes 21 to the financial statements. Consequently, I was unable to determine whether any further adjustments relating to revenue from exchange transactions in the financial statements was necessary.

Revenue from non exchange transactions

9. The municipality did not have adequate systems in place to maintain records of municipal property rates and taxes which resulted in property rates and taxes being understated by R5 432 861 in note 20 to the financial statements. Consequently I was unable to determine whether further adjustments were necessary to the amount disclosed for property rates and taxes.

Trade and other receivables

10. The municipality did not recognise the provision for impairment loss in accordance with Standard of Generally Recognised Accounting Practice, IAS 39, *Financial instruments: Recognition and measurement,* as the basis for the calculation of the impairment does not comply with the stipulations of IAS 39. Receivables with a net carrying amount of R36 897 285 (2011: R38 673 652) are included in note 4 to the financial statements without a proper assessment being made of the recoverability of these debtors. Consequently I was unable to determine the correct net carrying amount of receivables as it was impracticable to do so.

Irregular expenditure

11. The municipality did not have adequate systems in place to maintain records of irregular expenditure stated at R7 197 274 in the financial statements. In addition, sufficient appropriate audit evidence was not available for the amounts disclosed as irregular expenditure in note 38.8 to the financial statements. Consequently, I was unable to determine whether any adjustments were necessary to the amount disclosed for irregular expenditure.

Investment property

12. The municipality did not assess the fair value of investment property at each reporting date in accordance with Standard of Generally Recognised Accounting Practice, GRAP 16, *Investment property.* Investment property with a carrying value of R182 357 250 (2011: R182 357 250) is included in note 1.3 to the financial statements without a proper assessment by management to ensure that the value of investment property has not significantly changed. I have not determined the correct net carrying value of investment property as it was impracticable to do so.

Disclaimer of opinion

13. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Significant uncertainties

15. With reference to note 41 to the financial statements, the municipality is the defendant in lawsuits amounting to R9 395 920 but is opposing the claims. The ultimate outcome of the matter cannot currently be determined, and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

16. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered on 30 June 2012, and account balances in the financial statements of the //Khara Hais Local Municipality for the year ended 30 June 2012 have been reclassified.

Going concern

17. As disclosed in note 48 to the financial statements the municipality, on the basis of an assessment made by management, the prepared its financial statements on the going concern assumption; however, material uncertainties exist relating to conditions or events which may cast significant doubt on the municipality's ability to continue as a going concern, as explained below:

    - The municipality did not settle trade creditors amounting to R8 057 099 within 30 days.
    - The municipality's current ratio of 0.56:1 is significantly lower than the industry norm of 2:1
    - The municipality has a deficit to the amount of R131 125 132 for the year under review.
    - Conditional grants to the amount of R509 000 were withheld from the municipality for the financial year under review as disclosed in appendix F.

Material underspending of the conditional grant

18. The municipality has materially underspent on its conditional grants. At the date of this report underspending as disclosed in notes 15 and 16 to the financial statements amounted to R30 364 908 . This underspending is due to a lack of capacity which resulted in the municipality not achieving its planned targets.

Material losses

19. As disclosed in note 44 to the financial statements, material losses were incurred as a result of units lost during the distribution of electricity and water.

Type of material misstatement	Percentage of units lost	Rand value
Electricity units (Kwh)	6,32%	R6 434 342
Water distribution losses	38,8%	R6 750 635

Additional matters

20. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

21. The supplementary information set out on annexure A to F does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

Material inconsistencies in information included in the annual report

22. As the 2011-12 annual report had not been received at the date of this report, a conclusion could not be drawn on the consistency between the financial statements and audit report and the other information included in the annual report.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

23. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

24. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.

25. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information.*

    The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

26. The material findings are as follows:

Usefulness of information

Presentation

27. Section 46 of the Municipal Systems Act requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 46% of measures taken to improve performance as disclosed in the annual performance report. The municipality records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of the measures taken to improve performance.

Consistency

28. Section 41(c) of the Municipal Systems Act requires that the integrated development plan should form the basis of the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 46% of the reported indicators are not consistent with the indicators as per the approved annual performance. This is due to the lack of review performed to ensure that the reported indicators and targets are consistent with the planned indicators.

29. Section 41(c) of the Municipal Systems Act requires that the integrated development plan should form the basis of the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 41% of the reported targets are not consistent with the targets as per the approved annual performance. This is due to the lack of review performed to ensure that the reported indicators and targets are consistent with the planned indicators.

Measurability

30. The National Treasury *Framework for managing programme performance information* (FMPPI) requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 40% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
31. The National Treasury FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 80% of the targets. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
32. The National Treasury FMPPI requires that indicators/measures should have clear, unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 68% of the indicators/measures were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
33. The National Treasury FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 68% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information and the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Reliability of information

34. The National Treasury FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. The municipality could not provide sufficient appropriate evidence to support any of the selected programmes.
35. The municipality's records did not permit the application of alternative audit procedures regarding the validity, accuracy and completeness of the reported performance information.

Compliance with laws and regulations

36. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

37. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the Municipal Systems Act and Municipal Planning and Performance Management Regulation 6.

38. The municipality did not

- set measurable performance targets with regard to each development priority and objective.
- take steps to improve performance with regard to those development priorities and objectives where performance targets are not met, as required by section 41 of the Municipal Systems Act.

Budgets

39. Expenditure was incurred that was not budgeted for, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual reports

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of unauthorised expenditure, trade payables, commitments, IFRS 7, provisions and revenue from exchange transactions, identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were subsequently provided, but the uncorrected material misstatements resulted in the financial statements receiving a disclaimer audit opinion.

Procurement and contract management

41. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).

42. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

43. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.

44. Awards were made to providers who are persons in the service of the municipality, in contravention of SCM regulation 44. Furthermore, the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).

45. Awards were made to providers who are persons in service of other state institutions, in contravention of SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

Human resource management

Appointments

46. Sufficient appropriate audit evidence could not be obtained that the municipality had appointed a municipal manager, and managers directly accountable to the municipal manager, who had not been dismissed for financial misconduct after 10 years.

Performance management

47. The municipal manager did not sign the correct performance agreements, as required by section 57(2)(a) Municipal Systems Act.

Expenditure management

48. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

49. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.

50. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Transfer of funds and conditional grants

51. The allocation for conditional grants were utilised for purposes other than those stipulated in the *Division of revenue grant framework*, in contravention of section 15(1) of DoRA.

52. Unspent conditional grant funds not approved by the National Treasury for retention were not surrendered to National Revenue Fund, as required by section 20(1) of DoRA.

53. The municipality did not submit MFMA implementation plans to National Treasury to address weaknesses in financial management, as required by the *Division of revenue grant framework*, *Gazette No. 34280.*

54. The municipality did not submit its signed activity plan and/or did not do so in the prescribed format to the national department (CoGTA), as required by the *Division of revenue grant framework*, *Gazette No. 34280.*

55. The municipality did not submitted, within 20 days after the end of each month, its monthly expenditure reports to the national department (CoGTA), as required by the *Division of revenue grant framework*, *Gazette No. 34280.*

Revenue

56. A credit control and debt collection policy was not maintained and implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of MFMA.

57. An adequate management, accounting and information system was not in place which recognised revenue when it was earned, accounted for debtors and accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.

Asset management

58. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

59. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

60. The accounting officer did not, within 10 working days of the end of each month, submitted to the mayor a report describing, in accordance with generally recognised accounting practice, the investment portfolio at the end of the month.

61. All investments were not made in the name of the municipality, as required by Municipal Investment Regulation 12(2).

Internal control

62. I considered internal control relevant to my audit of the financial statements, the performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

63. The following challenges were experienced which contributed to the weaknesses in the financial environment and the ultimate audit outcome:

    - Personnel had not been assigned specific duties and responsibilities to facilitate the continuous monitoring of internal controls.
    - The leadership did not take appropriate action with regard to the lack of controls in the finance and supply chain management directorates, resulting in non-compliance with applicable legislation and inadequate budget control measures. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure.

64. Leadership did not regularly monitor management's compliance with laws, regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted.

Financial and performance management

65. The municipality did not have individuals who sufficiently understood the financial reporting framework and performance and financial management requirements, with the result that the municipality engaged a consultant to assist in the compilation of the fixed asset register and financial statements. The underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework.

66. Manual or automated controls were not designed to ensure that the transactions had occurred, were authorised and were completely and accurately processed. Documentation supporting amounts disclosed in the financial statements was not always available.

67. Management did not document and approve internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting on predetermined objectives. Consequently, performance systems, processes and procedures had not been designed and implemented.

Governance

68. The municipality did not respond to the assessed risks by determining a risk strategy and action plan to manage identified risks. Consequently, internal controls were not selected and developed to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

69. The financial statements were subject to material corrections resulting from the audit, which can be attributed to the lack of risk assessments, weaknesses in the design and implementation of internal control in respect of financial management and financial reporting, and weaknesses in the information systems.

70. Internal audit and audit committee did not adequately review the annual financial statements prior to submission, which resulted in numerous material misstatements not being corrected.

Auditor General

Kimberley

30 November 2012

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence